

Message Text

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ACTION ARA-14

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TO SECSTATE WASHDC 4313

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SUBJECT: GOB ADOPTS MEASURES TO LIMIT MONETARY EXPANSION

REF: A) BRASILIA 7687 B) BRASILIA 8605

1. SUMMARY- BRAZIL'S NATIONAL MONETARY COUNCIL APPROVED MEASURES ON OCTOBER 19 AIMED AT CONTAINING MONETARY EXPANSION AND AGGREGATE DEMAND DURING THE FOURTH QUARTER OF 1977. THE ACTIONS WERE PROMPTED PRIMARILY BY THE RECENT EXCESSIVE GROWTH IN THE MONEY SUPPLY THROUGH SEPTEMBER COMPARED TO THE MONETARY BUDGET TARGET. ANOTHER FACTOR WAS A MODERATE ACCELERATION OF INFLATION IN SEPTEMBER - OCTOBER. THE MEASURES INCLUDED INCREASES IN THE COMPULSORY RESERVE REQUIREMENT AND IN THE CENTRAL BANK DISCOUNT RATE. EARLIER IN THE WEEK THE GOB ANNOUNCED A REDUCTION IN THE LEVEL OF LENDING BY THE BANK OF BRAZIL THROUGH THE END OF 1977. END SUMMARY.

2. ACCORDING TO RESOLUTION 446 OF OCTOBER 19, THE NATIONAL

MONETARY COUNCIL INCREASED THE COMMERCIAL BANKS' COMPULSORY RESERVE REQUIREMENT FROM 35 TO 40 PERCENT OF SIGHT DEPOSITS. THE INCREASE
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WILL BE IMPLEMENTED IN TWO STAGES: BY 3 PERCENTAGE POINTS TO 38 PERCENT BY THE END OF OCTOBER, AND BY AN ADDITIONAL 2 PERCENTAGE POINTS TO 40 PERCENT BY THE END OF NOVEMBER. THE MEASURE PROVIDES THAT THE ADDITIONAL 5 PERCENT COMPUSORY RESERVES MAY BE HELD IN 2-YEAR TREASURY BONDS PAYING INTEREST OF 4 PERCENT PER ANNUM PLUS MONETARY CORRECTION. THE AUTHORITIES ARE EXPECTED TO ISSUE NEW TREASURY BONDS TO ABSORB THE ESTIMATED CR\$9.6 BILLION THAT

WILL BE WITHDRAWN FROM CIRCULATION. RESOLUTION 446 FURTHER PROVIDES THAT AFTER 180 DAYS THE CENTRAL BANK WILL REPURCHASE THE BONDS FROM THE BANKS AT THEIR NOMINAL VALUE.

3. THE MONETARY COUNCIL ALSO DECIDED TO INCREASE BY 2 PERCENTAGE POINTS THE CENTRAL BANK'S DISCOUNT RATE ON LOANS TO THE BANKING SYSTEM. THE NEW CHARGES WILL RISE TO 30 PERCENT ON BORROWINGS WITHIN THE NORMAL LIMIT OF 6 PERCENT OF SIGHT DEPOSITS AND TO 32 PERCENT ON CREDITS EXCEEDING THE ESTABLISHED CEILING. THE NEW DISCOUNT RATES TAKE EFFECT IMMEDIATELY. WHILE THE OFFICIAL ANNOUNCEMENT DID NOT SPECIFY HOW LONG THEY WILL APPLY, A CENTRAL BANK SPOKESMAN HAS INDICATED THAT 180 DAYS IS THE ANTICIPATED PERIOD.

4. APPROXIMATELY ONE WEEK PRIOR TO THE MONETARY COUNCIL MEETING, THE MINISTER OF FINANCE ANNOUNCED THAT PROJECTED LENDING BY THE BANK OF BRAZIL DURING THE FOURTH QUARTER WOULD BE CUT BY CR\$5 BILLION AS A MEANS OF RESTRAINING EXCESSIVE MONETARY AND CREDIT EXPANSION. WHILE HE STATED THAT AGRICULTURAL CREDIT AND EXPORT FINANCING WILL NOT BE AFFECTED, BANK OF BRAZIL PRESIDENT KARLOS RISCHBIETER PREFERRED NOT TO COMMENT ON WHICH AREAS OF THE BANK'S OPERATIONS MIGHT BE MOST AFFECTED.

5. COMMENT - AS SUGGESTED IN REF A THE GOB DECIDED IT MUST MAINTAIN A FIRM ANTI-INFLATIONARY POLICY STANCE IN ORDER TO ASSURE CONTINUED GRADUAL REDUCTION IN INFLATION IN THE REMAINDER OF 1977. LIMITED OFFICIAL USE

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THE DECISION TO ADOPT MEASURES TO TIGHTEN CREDIT WAS DIRECTLY RELATED TO MONEY SUPPLY GROWTH IN THE LAST TWO MONTHS AND THE ANTICIPATED SEASONAL EXPANSION IN THE LAST QUARTER OF THE YEAR. CUMULATIVE GROWTH IN THE MONEY SUPPLY (M1) THROUGH THE END OF SEPTEMBER WAS 17.6 PERCENT, IN CONTRAST WITH A MONETARY BUDGET TARGET OF 10.9 PERCENT. THE FINANCE MINISTER HAS INDICATED THAT AN EXCESS OF 6-7 PERCENTAGE POINTS FOR THE YEAR AS A WHOLE WOULD BE TOLERABLE SINCE THE ORIGINAL INFLATION TARGET OF 30 PERCENT IS CLEARLY NOT ATTAINABLE. ON THE OTHER HAND, THE RATE OF EXPANSION IN SEPTEMBER IMPLIED A CUMULATIVE TOTAL OF 35 PERCENT OR HIGHER, COMPARED TO THE TARGET OF 25 PERCENT. ANOTHER FACTOR IN THE GOB'S DECISION WAS THE ACCELERATION IN INFLATION IN SEPTEMBER (1.8 PERCENT COMPARED TO 1.3 PERCENT IN AUGUST) AND PRELIMINARY INDICATIONS THAT THE MONTHLY RATE MAY EXCEED 2 PERCENT IN OCTOBER (REF B). THE COMPOSITE CUT IN BANK LIQUIDITY OF NEARLY CR\$15 BILLION (CR\$ 5.0 BILLION FROM BANK OF BRAZIL AND CR\$9.6 BILLION FROM THE OTHER BANKS) IS EXPECTED TO HOLD MONEY SUPPLY GROWTH TO 30-35 PERCENT AND INFLATION TO 37-38 PERCENT IN 1977. COMMERCIAL BANKS HAVE REACTED WITH PREDICTIONS OF A REVERSAL IN THE RECENT DECLINE IN INTEREST RATES. THE PROPORTION OF DEPOSITS THAT IS FREELY LOANABLE HAS BEEN REDUCED TO 25 PERCENT IN VIEW OF THE REQUIREMENT THAT 15 PERCENT BE IN LOANS TO SMALL AND MEDIUM SIZED

BUSINESSES, 12 PERCENT IN AGRICULTURAL CREDITS, 8 PERCENT IN CASH
RESERVES, AND NOW 40 PERCENT IN COMPUSORY RESERVES. ON THE OTHER
HAND , BANKS ARE FAIRLY LIQUID AND SOME LEADING BANKERS HAVE
ACKNOWLEDGED THEIR AGREEMENT WITH THE NEW MEASURES AS NECESSARY
TO KEEP MONETARY GROWTH AND INFLATION UNDER CONTROL.
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